

Internal Revenue Service

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
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Date:
June 06, 2007

LEGEND:

Trust	=
Decedent	=
Daughter	=
Date 1	=
Date 2	=
<u>a</u>	=
Statute 1	=
Statute 2	=
Statute 3	=
Statute 4	=
Child 1	=
Child 2	=
Child 3	=
Subtrust 1	=
Subtrust 2	=
Subtrust 3	=
X shares	=

Dear :

This is in response to your May 31, 2006 letter and other correspondence requesting rulings concerning the gift and generation-skipping transfer (GST) tax consequences of the proposed renunciation of interests in a trust and the release of a testamentary limited power of appointment in the trust.

FACTS

Trust was created under the will of Decedent for the benefit of his daughter, Daughter, when Decedent died on Date 1. Trust provides for the trustees to pay Daughter so much, if any, of the net income as the trustees in their discretion deem necessary for Daughter's support, maintenance, and medical expenses. The trustees also have discretion to distribute the remaining income to Daughter. The trustees shall pay annually to Daughter as she requests \$a from principal. The trustees also have discretion to distribute principal in excess of \$a to Daughter.

Trust grants Daughter a testamentary nongeneral power to appoint, outright or in further trust, Trust principal to Decedent's lineal descendants. To the extent that Daughter does not exercise her power of appointment, the assets of the trust are to be divided equally among Daughter's children. The assets are to be distributed outright to the child of Daughter, if that child has attained the age of 40. If the child of Daughter has not attained the age of 40, then the assets are to remain in trust with 2/3 of the asset value being distributed at age 35 and the remaining value distributed when the child reaches age 40. Currently, Daughter has three children, Child 1, Child 2, and Child 3. If a child of Daughter dies before attaining the age of 40, the trustees are to continue the trust for the benefit of that child's issue.

Trust provides that notwithstanding any other provisions in the Will, any trust established under the terms of the Will shall terminate, if it is not previously terminated, twenty-one (21) years after the death of the last survivor of the group consisting of Decedent's wife, Decedent's three children, Child 1, Child 2, and Child 3, and any other issue of Decedent's mother, in being at the time of Decedent's death. Upon termination, the trustees shall pay the remaining principal and undistributed net income of Trust to such person or persons to whose income payments could be made under the terms of Trust immediately prior to its termination, and if there be no such persons, distributions will be made per stirpes.

Daughter proposes to renounce her entire beneficial interest in X shares in Trust. X shares will be divided into three equal parts and each part will be transferred into three new subtrusts, Subtrust 1, Subtrust 2, and Subtrust 3, each subtrust to benefit one of Daughter's children. Daughter will also release her testamentary nongeneral power of appointment over X shares in the three subtrusts. Each child will be the trustee and primary beneficiary of his or her own subtrust. Each child has an annual right to withdraw 5 percent of the value of the principal and undistributed income of that child's trust. No other distributions will be made to the child prior to the termination of that child's trust.

The subtrusts will continue for the lifetime of Daughter and, upon Daughter's death, the remaining assets of each subtrust will be distributed to the child of that subtrust, and, if the child does not survive Daughter, the remaining assets will be held in trust for the benefit of child's descendants and distributed in accordance with the same

provisions in Decedent's Will which pertain to Trust. Each subtrust contains the same termination provisions in Article Tenth of Decedent's Will that governs Trust.

Statute 1 provides that a beneficiary may renounce in whole or in part by filing a written instrument of renunciation.

Statute 3 provides, in relevant part, that unless the transferor of the interest has otherwise indicated in the instrument creating the interest, the interest renounced and any future interest which is to take effect in possession or enjoyment at or after the termination of the interest renounced, passes as if the person renouncing had died on the date the interest was renounced, if the renunciation is not within the nine month period set forth in Statute 2. The person renouncing shall have no power to direct how the interest being renounced shall pass.

Statute 4 provides that any interest in property which exists on Date 2, may be renounced after Date 2, as provided herein. An interest which has arisen prior to Date 2, in any person other than the person renouncing is not destroyed or diminished by any action of the person renouncing.

You represent that Statute 4 requires X shares to continue to be held in a trust until Daughter's death, so that, if a child of Daughter dies before Daughter, the interest of the deceased child is not destroyed or diminished. Accordingly, instead of distributing X shares outright in equal shares to each of Daughter's children, X shares will be transferred to the three subtrusts in equal shares and remain in each subtrust until the earlier of Daughter's death or the termination of the subtrust under the perpetuities provision in Trust.

You have requested the following rulings:

1. Daughter's renunciation of her entire beneficial interest in X shares will constitute a gift for purposes of § 2501.
2. Daughter's release of a testamentary nongeneral power of appointment over X shares will not constitute a gift of such property for purposes of § 2514.
3. Daughter's renunciation of her entire beneficial interest in X shares will not cause Trust to become subject to chapter 13.
4. Daughter's release of a testamentary nongeneral power of appointment over X shares will not cause Trust to become subject to chapter 13.
5. Daughter is the transferor of X shares transferred to the three subtrusts for purposes of chapter 13 and, accordingly, distributions and terminating distributions from the three subtrusts to skip persons are subject to GST tax.

LAW AND ANALYSIS

Ruling # 1

Section 2501(a) of the Internal Revenue Code imposes a tax for each calendar year on the transfer of property by gift by an individual.

Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) of the Gift Tax Regulations provides that the gift tax applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred upon another, regardless of the means or device employed, constitutes a gift subject to tax.

Section 25.2511-1(c)(2) provides that in the case of taxable transfers creating an interest in the person disclaiming made before January 1, 1977, where the law governing the administration of the decedent's estate gives a beneficiary, heir, or next-of-kin a right completely and unqualifiedly to refuse to accept ownership of property transferred from a decedent (whether the transfer is effected by the decedent's will or by the law of descent and distribution), a refusal to accept ownership does not constitute the making of a gift if the refusal is made within a reasonable time after knowledge of the existence of the transfer. The refusal must be unequivocal and effective under local law. There can be no refusal of ownership of property after its acceptance. In the absence of the facts to the contrary, if a person fails to refuse to accept the transfer to him of ownership of a decedent's property within a reasonable time after learning of the existence of the transfer, he will be presumed to have accepted the property.

Section 2512(a) provides that, if the gift is made in property, the value of the property at the date of the gift is considered the amount of the gift.

In this case, Trust was created on Date 1, prior to January 1, 1977. Daughter's renunciation of her entire beneficial interest in X shares will not be made within a reasonable time. Therefore, based upon the facts provided and the representations made, we conclude that Daughter's renunciation of her entire beneficial interest in X shares will constitute a gift from Daughter to the beneficiaries of the three subtrusts.

The value of the gift is a question of fact and the Service does not rule on such factual determinations. See Rev. Proc. 2007-1, 2007-1 I.R.B. 1, 14. However, since the gift is not an absolute right to distributions of income or principal, it cannot be valued by use of the tables contained in § 2512. See Deal v. Commissioner, 29 T.C. 730

(1958). Rather, the value of the gift should be determined in accordance with the general valuation principles contained in § 25.2512-1. Further, such an interest has more than a nominal value. See Rev. Rul. 67-370, 1967-1 C.B. 324.

Ruling #2

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that the term “general power of appointment” means a power which is exercisable in favor of the individual possessing the power, his estate, his creditor, or the creditors of his estate.

Daughter’s testamentary nongeneral power of appointment is exercisable only in favor of Decedent’s lineal descendants. Accordingly, Daughter does not possess a general power of appointment. Based upon the facts provided and the representations made, we conclude that Daughter’s release of a testamentary nongeneral power of appointment over X shares will not constitute a gift of such property for purposes of § 2514.

Rulings ## 3, 4, 5

Section 2601 imposes a tax on every generation-skipping transfer made after October 26, 1986.

Section 2611 provides that the term “generation-skipping transfer” means a taxable distribution, a taxable termination, or a direct skip.

Section 2612(a) provides that the term “taxable termination” means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust. Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Section 26.2612-1(e)(1) of the Generation-Skipping Tax Regulations provides that, for GST purposes, an interest in trust exists if a person has a present right to receive trust principal or income or is a permissible current recipient of trust principal or income.

Section 2613(a) provides that the term “skip person” means a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor; or a trust in which all the interests are held by skip

persons, or a trust where, if there is no person holding an interest in such trust and at no time after such transfer, may a distribution (including distributions on termination) be made to a non-skip person.

Section 2631(a) provides that for purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption amount which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

Section 2632(c)(1) provides that if any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. Section 2632(c)(3)(A) provides that the term "indirect skip" means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust (as defined under § 2632(c)(3)(B)). Section 2632(c)(5) provides that an individual may elect to have this subsection not apply to any or all transfers made by such individual to a particular trust.

Section 2652(a) provides that the term "transferor" means, in the case of any property subject to the tax imposed by chapter 12, the donor. Section 26.2652-1(a)(1) provides, in part, that the individual with respect to whom property was most recently subject to federal estate or gift tax is the transferor of the property for purposes of chapter 13. An individual is treated as transferring any property with respect to which the individual is the transferor. Thus, an individual may be a transferor even though there is no transfer of property under local law at the time the federal estate or gift tax applies.

Under section 1433(a) of the Tax Reform Act of 1986 (Act) and section 26.2601-1(a), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under section 1433(b)(2)(A) of the Act and section 26.2601-1(b)(1)(i), the GST tax provisions do not apply to any generation-skipping transfer under a trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). However, this exemption does not apply to a pro rata portion of any generation-skipping transfer under an irrevocable trust if additions are made to the trust after September 25, 1985.

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13, the trust is thereafter deemed to consist of two portions, a portion not subject to chapter 13 (the non-chapter 13 portion) and a portion subject to chapter 13 (the chapter 13 portion), each with a separate inclusion ratio (as defined in section 2642(a)). See

§ 26.2654-1(a)(2) rules for treating additions to a trust by an individual other than the initial transferor as a separate trust for purposes of chapter 13.

Section 26.2654-1(a)(2)(i) provides that if there is more than one transferor with respect to a trust, the portions of the trust attributable to the different transferors are treated as separate trusts for purposes of chapter 13. Under § 26.2654-1(a)(4)(i), with respect to a separate trust under § 26.2654-1(a)(2), an individual's GST exemption is allocated to the separate trust.

Section 26.2601-1(b)(1)(v)(A) provides that where any portion of a trust remains in trust after the post-September 25, 1985, release, exercise, or lapse of a power of appointment over that portion of the trust, and the release, exercise, or lapse is treated to any extent as a taxable transfer for federal estate or gift tax purposes, the value of the entire portion of the trust subject to the power that was released, exercised, or lapsed is treated as if that portion had been withdrawn and immediately retransferred to the trust at the time of the release, exercise, or lapse. The creator of the power will be considered the transferor of the addition except to the extent that the release, exercise, or lapse of the power is treated as a taxable transfer for federal estate and gift tax purposes.

Section 26.2601-1(b)(1)(v)(B) provides that the release, exercise, or lapse of a power of appointment (other than a general power of appointment as defined in § 2041(b)) is not treated as an addition to a trust if such power of appointment was created in an irrevocable trust that is not subject to chapter 13 under section 26.2601-1(b)(1).

Trust was executed prior to September 25, 1985, and it is represented that there have been no additions (actual or constructive) to Trust since that date. Accordingly, Trust is not subject to chapter 13. Daughter's renunciation of her entire beneficial interest in X shares is a taxable transfer for gift tax purposes. X shares will be transferred into three subtrusts in which Daughter will have no interest. The property remaining in Trust continues to be subject to the original Trust provisions, with no modifications to those provisions. Based upon the facts provided and the representations made, we conclude that Daughter's renunciation of her entire beneficial interest in X shares will not cause Trust to become subject to chapter 13.

As discussed above, Daughter holds a testamentary nongeneral power of appointment over Trust. Daughter will release this power over X shares that are transferred to the three subtrusts. The power of appointment was created in Trust, an irrevocable Trust, that is not subject to chapter 13. Therefore, the release of the power of appointment over X shares will not be treated as a constructive addition to Trust. Accordingly, based upon the facts provided and the representations made, we conclude that the release of Daughter's testamentary nongeneral power of appointment over X shares will not cause Trust to become subject to chapter 13.

As stated above, under § 2652, for purposes of chapter 13, Daughter is the transferor of X shares that will be transferred to the three subtrusts. Accordingly, the three subtrusts are not exempt from chapter 13 by virtue of Trust's exemption. Daughter may allocate her GST exemption to the three subtrusts at the time of the transfer or GST exemption may be automatically allocated under § 2632(c)(1) depending on whether the subtrusts are GST Trusts as defined in that Code section. Based upon the facts provided and the representations made, we conclude that Daughter is the transferor of the X shares that will be transferred to the three subtrusts for purposes of chapter 13 and, accordingly, distributions and terminating distributions from the subtrusts to skip persons are subject to GST tax.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express or imply no opinion on the value of Daughter's gift to the three subtrusts.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Pursuant to the Power of Attorney on file with this office, this letter is being sent to the taxpayer's representative.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures

Copy for section 6110 purposes
Copy of this letter

cc: